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# **LEGISLATIVE FISCAL REPORT**

## **2007 Biennium**

### **Volume 1 – Statewide Perspectives**

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Presented to the Fifty-ninth Legislature

Submitted by

The Legislative Fiscal Division

Helena, Montana

June, 2005

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# MONTANA LEGISLATIVE BRANCH

## Legislative Fiscal Division

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June 2005

Members of the Fifty-ninth Legislature  
Members of the Legislative Finance Committee

In accordance with the provisions of Section 5-12-302, I submit the Legislative Fiscal Report for the 2007 Biennium. The report provides an overview and details of the 2007 Biennium budget for the State of Montana adopted by the 59th Legislature.

This four-volume report includes:

- Volume 1: Statewide Perspectives – This volume provides a general summary of the 2007 Biennium state budget as well as significant fiscal policy addressed by the 2005 Legislature. It also contains a general reference section.
- Volume 2: Revenue Estimates – This volume provides the revenue estimates and underlying economic assumptions adopted by the 59th Legislature.
- Volumes 3 and 4: Agency Budgets – These volumes provide a detailed report of the appropriations for each agency and program contained in the general appropriations act (House Bill 2) and in other legislation.

These volumes are intended as a reference document and historical archive of legislative budget action for the use of legislators, the public, and state agencies.

Respectfully submitted,

Clayton Schenck  
Legislative Fiscal Analyst



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# HOW TO USE THIS REPORT

The *Legislative Fiscal Report, 2007 Biennium* is published in four volumes. The report was designed to report to the 2005 Legislature and all interested parties on the fiscal actions of the 2005 Legislature (including both legislation passed and stated legislative intent related to fiscal issues) and the fiscal status of state government through the 2007 biennium. It accomplishes its purpose by: 1) reporting on appropriations to and revenues of state government as determined by the legislature; and 2) discussing other fiscal issues pertaining to the state's fiscal status.

## VOLUME 1

*Volume 1*, which includes a legislative summary, provides a “broad brush” overview and summarizes significant fiscal actions that impact more than one agency or that did not fall under the jurisdiction of a single appropriation subcommittee.

This volume contains these major sections:

- 2007 Biennium Budget Overview – an executive summary
- Legislative Budget Summary
- Budget Comparisons
- Other Budget or Fiscal Actions
- 2009 Biennium Outlook
- General Reference

Explore these sections for a summary of legislative actions. The “2007 Biennium Budget Overview” section on pages 1 through 30 provides a high level summary of the material presented in Legislative Fiscal Report.

An index in the back of *Volume 1* is the most comprehensive for the purpose of searching for information in all four volumes.

## VOLUME 2

*Volume 2* includes a summary and overview of the state's major revenue sources, including the general fund. It delineates the economic assumptions used to derive revenue estimates as adopted by the legislature in House Joint Resolution 2 and in other revenue bills.

## VOLUMES 3 AND 4

*Volumes 3 and 4* offer detailed discussions of the appropriations established by the legislature for each agency and program in state government that receives an appropriation in HB 2. Agency presentations are grouped in sections corresponding to the appropriations subcommittee addressing the agency.

### **VOLUME 3:**

- House Bill 2 (the general appropriations act)
- Section A – General Government and Transportation
- Section B – Health and Human Services

### **VOLUME 4:**

- Section C – Natural Resources and Commerce
- Section D – Corrections and Public Safety
- Section E – Education
- Section F – Long-Range Planning

A specific agency can be located in any of three ways. The general index included in each volume provides an alphabetical listing of agencies and other topics, in conjunction with appropriate volume and page numbers. If the subcommittee addressing a given agency is known, the cover page of each section lists agencies, in order by appearance. Agency names are also visible on page headings within sections.

*Volumes 3 and 4* briefly describe the agencies from all three branches of state government, as well as each program within an agency. The basic structure used for the report is consistent across agencies. These volumes detail an agency's appropriations, both in tables and narrative. These volumes present detailed discussions of present law adjustments, new proposals, new legislation, and significant fiscal issues by agency as identified by fiscal staff.

Agency budgets are presented in three tiers as required by statute:

- **Base budget:** the level of funding authorized by the previous legislation;
- **Present law base:** the additional level of funding authorized under present law to maintain operations and services at the level established by the previous legislature; and
- **New proposals:** appropriations to provide new non-mandated services, to change program services, to eliminate existing services, or to change sources of funding.

By making this presentation in this tiered manner, the reader is able to see how the budget evolved from the base budget to the total amount appropriated, and the incremental increases or decreases that make up the total budget.

## **PROPRIETARY RATE SETTING**

The 1995 legislature, in HB 576, removed the requirement that proprietary – or internal service and enterprise – funds be appropriated by the legislature. Instead, as provided in Section 17-8-101, MCA, the legislature approves the rates charged for those particular services and products. It also requires the Office of Budget and Program Planning to submit a report as part of the Executive Budget. The proprietary rates that the legislature approved can be found in Section R of HB 2 (located at the beginning of *Volume 3*). There are also brief discussions of the rates in the relevant agency sections.

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What is the state's fiscal outlook?  
How did the Legislature balance the budget?  
What were the major fiscal challenges, solutions, and issues?



## **INTRODUCTION: FISCAL OUTLOOK, CHALLENGES & SOLUTIONS**

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### **PREFACE**

After facing a period of severe revenue shortfalls, Montana is seeing a dramatic turnaround in key revenue sources. Revenues from individual income and oil and gas taxes increased significantly in 2004 and early 2005. Rather than beginning the 2005 session with a large deficit, as was the case in 2003, the legislature started with a large projected fund balance as of the end of FY 2005. But the available balance is not necessarily what it appears to be, as a significant portion is from one-time, nonrecurring revenue. That means there is some risk in using these revenues for ongoing programs or services. In what is always a challenging fiscal environment, the 59<sup>th</sup> Legislature faced an opportunity to shape a budget that addressed some of the state's ongoing fiscal issues while at the same time taking on some very daunting emerging fiscal challenges, including the school funding lawsuit, significant caseload and inflationary increases in human services, prisoner population increases in corrections, a backlog in state infrastructure maintenance, and creation of a state office of the public defender.

In this first section, we provide an executive summary of the 2007 biennium budget as adopted by the 59<sup>th</sup> Legislature. It includes a brief overview of the state fiscal picture that faced the legislature, how the legislature balanced the budget, and a summary of the fiscal challenges and legislative solutions to those challenges. Next, it provides highlights of the budget adopted by the legislature. A budget comparisons summary follows that provides a point of reference for the 2007 biennium budget as compared to: 1) the executive budget request; 2) the 2005 biennium; and 3) by fund type. It further includes a summary of significant budget and fiscal actions that are global in nature or relate to more than one agency (for example, the state pay plan).

- In a nutshell, this section provides summary answers to the following questions:
- What is Montana's fiscal outlook?
- How did the legislature balance the budget?
- What were the major fiscal challenges, solutions, and issues?
- What are the major highlights of the 2007 biennium budget?
- How does the 2005 biennium budget compare to:
  - The Executive Budget Proposal?
  - Prior biennium expenditures?
  - Fund Sources?
- What other fiscal issues addressed by the 2005 legislature are important to consider?
- What might we expect for the 2009 biennium?

The items in this executive summary are presented in more detail in the remaining chapters of this volume.

## 2007 BIENNIUM FISCAL/ECONOMIC OUTLOOK

The 1990's were generally good years for Montana's economy. With a few exceptions, Montana experienced above average employment and wage levels that translated into strong tax revenue growth. This revenue growth was further enhanced by the significant increase in the equity markets and the resulting growth in capital gains income. During calendar 2002 and 2003, however, the state's financial picture blurred as the effects of a national economic recession, terrorism threats, and mid-east tensions played havoc on the US economy. Although Montana's economic base remained relatively stable during this period, state general fund revenues plummeted. This inconsistency was due to the precipitous fall in equity markets, low interest rates, and reduced corporate profits. All of these factors contributed to the 2002/2003 budget crisis while the state's economy continued to outperform the national economy.

Beginning in fiscal 2004, Montana's revenue picture continued to show signs of weakness. Income tax receipts were sluggish, interest rates continued at historic low levels, and corporation income tax refunds were significant. In early calendar 2004, however, the first signs of an improving revenue picture started to appear. By early June 2004, after most individual and corporation income tax returns were processed, it was quite apparent that both of these key revenue sources were going to exceed legislative expectations. At this same time, oil and natural gas tax revenues were mushrooming and investment earnings were improving.

The three income sources primarily responsible for Montana's revenue picture reversal are individual income, corporation income, and oil and natural gas taxes. Individual income tax has experienced increased growth resulting in large part from the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 (federal tax policy changes), an improvement in wage growth (especially in real wage growth per worker), and a higher capital gains base in calendar 2003. The corporation income tax has rebounded as Montana and multi-state corporations have recovered from the 2001 recession and the effects of "9/11". Additionally, the impact of the federal stimulus bonus depreciation provisions of calendar 2002 and 2003 will now create a decrease in the amount of depreciation expense corporations can claim in future years. This will result in increased tax liabilities. Finally, both oil and natural gas prices have increased dramatically in response to the war in Iraq and uncertainty about future supplies. As a result of the higher prices, new drilling activity for oil is up substantially. Production levels are once again increasing, reversing the production declines observed during the last ten years.

In summary, revenue growth is expected to be moderate through the 2007 biennium, and when coupled with a large beginning general fund balance, the 2005 Legislature faced a nearly unprecedented available balance as it prioritized state spending. Montana generally escaped the economic recession of the early 2000s, and state revenues are expected to recover in the 2005 and 2007 biennia from the significant declines in the 2003 biennium.

The cost of governmental services continue to increase even with a moderate rate of inflation and a slow growth rate in total population. School enrollments are declining, yet costs to support public schools continue to increase, especially in view of the recent court decision that schools are underfunded. Human services costs continue to escalate because of greater caseload demands, higher medical costs, and a higher state Medicaid match rate to due improved per capita incomes. Corrections population growth projections also compel significant expenditure growth.

While the legislature faced a brighter picture than two years ago, caution was in order. Income tax growth will be impacted during the transition to SB 407 (tax reform), and the full effects of the SB 407 tax cuts will not be fully felt until fiscal 2008, when the increase in the capital gains credit to 2 percent becomes effective for a full fiscal year. The bonus depreciation provisions will not add to corporation tax liabilities past the 2007 biennium. Furthermore, there is always uncertainty surrounding the price of oil and a quieting of the war in Iraq could send oil prices down sharply, slowing new drilling activity.

With this fiscal outlook in mind, the next section explains how the legislature prioritized and balanced the 2007 biennium budget.



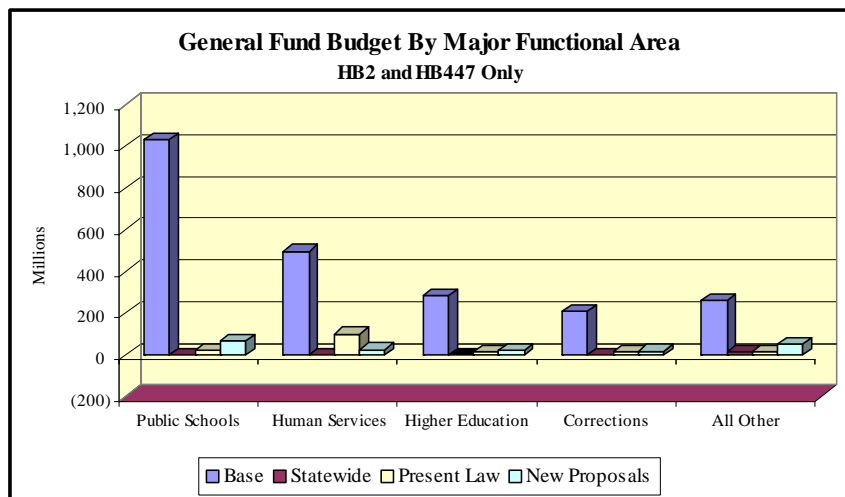
## 2007 BIENNIUM BUDGET SOLUTIONS

The legislature convened with an unusually high general fund available balance after funding “present law” services for the 2007 biennium. This available balance gave the legislature an opportunity to approach the budget in a far different way than was open to the previous legislature. The revenue shortfall faced by the previous legislature had left few options for building a balanced budget. The 2005 Legislature was able consider budget solutions that would restore many of the reductions required of the previous legislature and to address some budget issues that the state has not been able to address in some time.

The available balance in the general fund for the 2007 biennium was \$522.9 million before any legislative action (funding for base budget only). The projected ending fund balance after all legislative action for both fiscal 2005 and the 2007 biennium adjustments is \$76.0 million. The following figure shows in a summary fashion, how the budget was built.

Figure 1 shows the general fund budget for the 2007 biennium by major functional area (public schools, human services, higher education, corrections, all other). The amounts shown in Figure 1 are the appropriations contained in HB2 (general appropriations act) and HB447 (employee pay plan) categorized by base, statewide adjustments, present law adjustments, new proposals, and total budget.

Figure 1



Major Functional Area	Base Times 2	Statewide Adjust.	Present Law	New Proposals	Total Changes	Total Budget
Public Schools	1,028.170	0.311	22.567	64.412	87.290	1,115.460
Human Services	496.898	2.102	100.084	25.471	127.657	624.555
Higher Education	281.558	(2.846)	11.785	23.819	32.758	314.316
Corrections	208.038	1.043	16.809	18.804	36.656	244.694
All Other	260.910	14.816	15.460	50.256	80.532	341.442
<b>Totals</b>	<b>\$2,275.574</b>	<b>\$15.426</b>	<b>\$166.705</b>	<b>\$182.762</b>	<b>\$364.893</b>	<b>\$2,640.467</b>
<b>Percent of Total Amount</b>						
Public Schools	45.18%	2.02%	13.54%	35.24%	23.92%	42.24%
Human Services	21.84%	13.63%	60.04%	13.94%	34.98%	23.65%
Higher Education	12.37%	-18.45%	7.07%	13.03%	8.98%	11.90%
Corrections	9.14%	6.76%	10.08%	10.29%	10.05%	9.27%
All Other	11.47%	96.05%	9.27%	27.50%	22.07%	12.93%

As indicated in the figure, public schools received the largest allocation of available funds at \$1.115 billion (42.2 percent) of the authorizations contained in HB2 and HB447. Human services was allocated \$624.6 million (23.7 percent) while higher education received \$314.3 million (11.9 percent) with corrections receiving \$244.7 million (9.3 percent). All “other” agencies of state government were allocated \$341.4 million (12.9 percent). These distributions might indicate the overall prioritization process of the legislature.

The figure also shows the total amount of change adopted as statewide adjustments, present law adjustments, and new proposals (total change). From the perspective of the change amount, human services was top priority for funding since that area received 35.0 percent of the total change amount or \$127.7 million. Public schools received 23.9 percent of the change amount or \$87.3 million.

In summary, the 59<sup>th</sup> Legislature adopted a balanced budget for the 2007 biennium with a projected ending fund balance of \$76.0 million. The budget solution was crafted with a significant number of budget changes. The largest new proposal was for the employee pay plan of \$37.6 million general fund, which was passed early in the session (see page 105 for details). In some instances, one-time moneys were earmarked for one-time expenditures such as the Crow Tribe settlement, the highway patrol lawsuit settlement, and to address deferred maintenance of state facilities. In other instances, the legislature was able to restore funding for human service programs that saw service reductions in the previous biennium. Public education received a significant boost, but addressing the budget relative to school funding lawsuit was deferred to further study with a special session tentatively planned for late 2005. These actions and many other are described in later sections of this report.

There were a significant number of tax policy revenue bills enacted but these impacts combined with revenue estimate adjustments had an insignificant impact on the 2007 biennium revenues.

The budget as passed is structurally balanced, meaning that ongoing revenues are sufficient to fund ongoing appropriations included in the budget.

## 59<sup>TH</sup> LEGISLATURE: FISCAL CHALLENGES AND SOLUTIONS

The *Legislative Budget Analysis 2007 Biennium*, released in January 2005, identified a number of major fiscal challenges that the 59<sup>th</sup> Legislature would face when it convened. Although a sizable available balance was anticipated (and is still projected) for the end of the 2005 biennium, there were some very significant issues to be addressed, including public school funding with a potential huge price tag, rising health care costs, the potential for the loss of federal funds, and questions of the sustainability of general fund revenues.

The preceding pages describe the fiscal and economic outlook for Montana and provide a broad-brush summary of budget solutions. Those pages are a prelude to discussions of the actions of the legislature during the 86-day regular session. For further perspective, the following summarizes the key challenges and uncertainties that the legislature had to consider in formulating the 2007 biennium spending plan and addressing related fiscal issues. Below each is a summary of legislative actions and potential remaining issues and concerns.

### Fiscal Challenge

**Funding for schools** was arguably the number one fiscal challenge in view of a district court decision in April of 2004 (upheld by the Montana Supreme Court in November 2004) finding that state funding for K-12 education is not adequate and that the current funding methodology is unconstitutional. The state is directed by the court to find a solution by October 2005. The magnitude of the K-12 education budget, the complexities of determining a solution, and the limited time frame for finding a solution will make this issue difficult to resolve.

**Legislative Action:** The 59th legislature faced a daunting challenge. In response to a December 2004 Supreme Court preliminary decision, the Legislature was faced with the requirement to: 1) define a basic system of quality schools, 2) “cost out” the resources required to deliver a basic system of quality education, 3) develop a funding formula to distribute budget authority among school districts, and 4) develop the revenue stream to pay for the funding formula. The Supreme Court issued their final order in March 2005 affirming the District Court’s decision (Sherlock) that the legislature provide a remedy to the school-funding problem by October 1, 2005.

The 59th Legislature was successful in achieving the first objective in the regular session, but not the last three. In passing SB 152, the legislature created a definition of a basic quality school system that includes recognition of the resources required and the population served. An interim committee created by SB 525 will conduct the cost study, develop the funding formula and recommend revenue changes in preparation for a special session on school funding tentatively scheduled for December 2005.

**Issue:** The short time frame for the cost study and formula development will mean a limited scope and that the process will not be able to take account of all relevant factors, and therefore will be an ongoing process beyond the special session.

**Fiscal  
Challenge**

**Health care cost inflation and caseload increases** continue to be major contributors to greater than average growth in health care services budgets. With medical cost growth well ahead of normal inflation and prescription drug increases in double digits, there is no relief in sight. This trend follows recent years of budget reduction caused by revenue shortfalls. Add to that the growing caseloads needing services, fueled to some degree by an aging population, growing demands for increases in funding, and reductions in the federal Medicaid rate. Underestimating costs could result in a budget-breaking supplemental request or further reductions in health care services.

**Legislative Action:** The legislature considered several issues related to health care cost inflation, especially as it contributes to the number of uninsured or underinsured Montanans. The legislature also considered public health programs that fund health services for low-income persons in Montana. Also, the legislature, in implementing voter Initiative I-149, passed two bills to create state funded programs to assist: 1) low-income Montanans in purchasing prescription drugs, and 2) small businesses in providing health insurance coverage for their employees. Additionally, the legislature approved funding to expand enrollment in the Children's Health Insurance Program (CHIP) from 10,900 to 13,900 children annually. The legislature also used I-149 tobacco tax revenue to fund Medicaid community service and children's eligibility expansions (HB 552). The use of I-149 and components of the new programs are discussed more thoroughly in Volume 1 on page 124 and in Volume 3, page B-6.

**Issue:** As always, the issue related to publicly funded health care programs is the funding necessary to support the ongoing program cost. In the case of the prescription drug and premium assistance programs, and CHIP expansion enacted to comply with I-149, the programs are funded from a source of revenue that is expected to decline if state efforts to control and prevent tobacco use are successful.

**Fiscal  
Challenge**

**Correctional offender population** continues to grow. From FY 1997 through FY 2004, the number of offenders in both secure custody and community supervision increased from 7,453 to 10,353, or 38.9 percent. The average daily population for FY 2004 is estimated to have a 4.5 percent increase over FY 2003. Controlling expenditures in this area of the budget can go way beyond simply funding incarceration or supervision programs. It requires legislators to look at sentencing criteria, alternative correction programs, ways to rehabilitate offenders more quickly, and ways to keep people out of the criminal justice system.

**Legislative Action:** The legislature was not in favor of expanding the private prison in Shelby by 500 beds during the 2007 biennium as originally recommended in the executive budget. Instead, the legislature approved funding for more prerelease beds and a revocation center (for temporary placement of persons who have violated parole or probation) at Montana State Prison. It preferred that the majority of funding approved for contract beds be used to finance a facility that would treat special needs prisoners. Special needs prisoners are those with mental or physical health issues (including elderly prisoners), drug problems, and sex offense convictions.

**Issue:** All of the secure facilities, with the exception of the private prison in Shelby, will be well above their rated capacities or at or above their operational capacities during some point in the 2007 biennium.

**Fiscal  
Challenge**

**Higher education** has been funded to a greater and greater degree in recent biennia with increased tuition charges to students, as general fund becomes a smaller share of total funding. The legislature will need to reconcile the difference between what the total state funded share of higher education should be, and what the state can afford.

**Legislative Action:** In an effort to keep student tuition rates lower while working within the constraints of the current state funding formulas, the legislature took two actions that will have an impact on funding for the university system and an impact on tuition rates. These two budget actions, motivated in part by a concern that enrollment increases for the 2007 biennium are projected to be flat (which would keep present law budget adjustment increases low) include:

The legislature modified the present law adjustment formula for the university educational units by funding these adjustments in the 2007 biennium at approximately 80 percent, as opposed to the historical level, which would have been 43 percent. The 80 percent level reflects the approximate ratio of Montana resident students to non-resident student enrollment at the university units. This formula adjustment increased present law funding by approximately \$5.3 million over the 2007 biennium.

- The legislature also modified the marginal cost per student formula by carrying over the calculation from the 2005 biennium rather than updating this calculation using FY 2004 base year data, thus negating the mathematical anomaly in the formula that drives the state funding level downward. By carrying forward the 2005 biennium calculation, the legislature increased the present law adjustment funding to support enrollment increases by \$108,000 over the 2007 biennium.
- In spite of these legislative actions to remediate tuition rate increases, the Board of Regents approved tuition rates in May 2005 that will increase tuition an average of 8.6 percent per year in the 2007 biennium across the university units. These tuition increases range from as high as 12 percent per year at MSU-Bozeman and Montana Tech, to as low as 3 percent per year at the Billings College of Technology and 3.1 percent per year the Great Falls College of Technology.

**Issue:** Part of the reason that state funding to support the cost of education has declined for the university system is that the funding formulas that the legislature uses to set budgets have a mathematical anomaly that drives the state percentage downward each biennium simply due to the mathematics, separate from public policy matters. Since the adoption of the lump-sum funding method, whereby the legislature appropriates state funds to the university units in a single block amount so that the Board of Regents may direct the allocation in accordance to their constitutional governance authority, the funding formulas have become distanced from substantive public policy considerations by the legislature. Two legislative options to address this issue include: 1) consideration of budgeting for the university system based upon accountability measures that would serve to establish the outcomes and product the legislature wishes to fund at the university units, which would then engage the legislature in more substantive public policy setting relative to the university system budget; and 2) consideration of alternate funding formulas and methodologies that would at least, in part, be based firmly upon matters of policy, such as what specific percentage share of the cost of education the legislature believes it owes to Montana resident students, rather than being based upon mathematics.

**Fiscal  
Challenge**

**State employee pay and benefits** were expected to be a hot topic for the 2005 session. State employees received no salary increase in FY 2004 and a 25-cent per hour increase in FY 2005, which was delayed to take effect mid-year. However, the state contribution to employee health insurance benefits attempted to keep pace with the growth in those costs, costs that continue to climb. With the revenue picture improved, state employee union representatives sought some redress of employee compensation issues.

**Legislative Action:** The legislature addressed employee pay and benefits early in the session with the passage of HB 447. The legislation provides a 3.5 percent (or \$1,005, whichever is greater) increase in salary for most employees beginning on October 1, 2005, with a further 4.0 percent (or \$1,118, whichever is greater) increase beginning October 1, 2006. In addition, employer contributions toward health insurance costs will increase on January 1 of each year by \$46 per month in 2006 and \$51 per month in 2007. The estimated cost of this action in the 2007 biennium is \$37.6 million general fund and \$37.2 million other funds (includes a contingency fund).

**Issue:** As is usually the case, the delayed effective dates for the components of the pay plan, salary increases on October 1 of each year and health insurance increases on January 1 of each year, will result in sizable statewide present law adjustments for the next budget as each increase will need to be annualized to reflect full funding in the biennia following the 2007 biennium. The annualized cost in the 2009 biennium is estimated at about \$60.6 million general fund and \$58.9 million other funds.

**Fiscal  
Challenge**

**Public employee retirement funds** have suffered from lower interest rates and equity market losses. Reduced investment earnings have resulted in actuarial estimates of unfunded liabilities that exceed acceptable levels.

**Legislative Action:** Two bills (HB 148 and HB 181) that were intended to partially address the unfunded liabilities of the Public Employee Retirement System and the Teachers Retirement System were considered but not passed. Instead, the legislature passed HJR 42 which requested an interim legislative study on how public employee retirement funds are invested and how investment performance, retirement plan benefits, and legislative policy decisions interact to affect the actuarial soundness of the public employees retirement plans and public employers' funding obligation.

**Issue:** Since the legislature took no action to change the employer contribution rates, the unfunded liability remains and is conditional to a degree on the performance of the investments held by the retirement systems.

**Fiscal  
Challenge**

**Management of capital assets** is an important function of state government. A key component is the maintenance of state facilities and other assets. The deferral of such maintenance has been a long-standing issue, made worse by the budget shortfalls of recent years. Delaying maintenance activities can result in higher future costs as facilities deteriorate beyond the need for ordinary repairs and replacements.

**Legislative Action:** The highest priorities in the cash portion of long-range building proposals are for repair and maintenance activities. The legislature approved a one-time transfer of \$30.1 million from the general fund to the long-range building account in order to reduce the growing statewide backlog of

safety, major repairs, and deferred maintenance projects. This is in addition to a projected cash balance of \$5.5 million in the long-range building fund, for a total amount of \$35.6 million.

**Issue:** Although the \$30.1 million transfer is a significant chunk of money applied to the deferred maintenance problem, a sizable amount of maintenance is still needed around the state. The estimated value of total maintenance projects that have not been funded is estimated to be over \$150 million. The legislature approved \$8,000 for a study of the deferred maintenance program.

### Fiscal Challenge

**Public defender services** were the topic of a subcommittee of the legislative Law and Justice Interim Committee during the 2003-2004 interim. Partially in response to a pending lawsuit (on hold until May 2005), the subcommittee drafted legislation to create a statewide public defender system to address issues raised by the American Civil Liberties Union (ACLU) in its lawsuit. The ACLU alleges that public defender services are not provided throughout the state in an equitable manner and that it is a conflict of interest when a judge appoints a public defender in a case that will be heard by that judge.

**Legislative Action:** The legislature approved SB 146 that established the Office of State Public Defender and provided general fund of \$14.7 million and 90.25 FTE for the biennium. About \$8.4 million of the costs of this office and 4.50 FTE will be transferred from other state agencies, the majority of which will come from the Judiciary. Under SB 146, FY 2006 would be a year of transition. The funding for a biennium without a transition year would be approximately \$28.3 million. Please refer to the write-up on the Office of State Public Defender on page 129 of this volume for more detail.

**Issue:** The ACLU has sent a letter to the district judge that has jurisdiction over this issue asking that the trial date be cancelled indefinitely. However, the ACLU is still reviewing the issue on the adequacy of funding for this effort.

### Fiscal Challenge

**Pending litigation and subsequent court rulings** can impact state finances. Currently, there is one legal action pending that seeks changes and increased funding for services for the developmentally disabled: the Montana Association for Independent Disability Services, Inc. (MAIDS) lawsuit. Another lawsuit pending relates to compensation issues for highway patrol officers and could result in an award of back pay. In addition, during FY 2004, two decisions were rendered that will have potential fiscal impact in the upcoming biennium: 1) the Montana Advocacy Program (MAP) Travis D. class action lawsuit; and 2) the lawsuit which challenged the adequacy of state funding for schools (discussed on page 111 under "Public School Funding").

**Legislative Action:** The legislature considered information and funding requests related to the changes in the Developmental Disabilities System, including the impact of the settlement of the Travis D litigation and the pending MAIDS litigation. The legislature provided funding to complete movement of 45 individuals from the Montana Developmental Center to community settings and for training, crisis services, start up costs for new services, movement of 15 individuals from the waiting list into services, and an increase in the direct care worker wage benchmark in the published rate schedule. The MAIDS litigation is not yet resolved so the impacts of that litigation are not yet known. With regard to the highway patrol officers' lawsuit, the legislature approved a supplemental appropriation of \$8.5 million to pay for the settlement of this lawsuit.

**Issue:** The potential liability in the other pending litigation is unknown, but could be substantial. The legislature needs to be cognizant of the MAIDS lawsuit and or other outstanding items for the future.

**Fiscal  
Challenge**

**Supplemental emergency appropriations** for the next biennium are not budgeted by the legislature and not accounted for in the ending fund balance. The state continues to experience supplemental appropriations each biennium, particularly for fire suppression, although for FY 2005, no fire costs supplemental is expected. Fire costs for FY 2005 were funded by a one-time federal grant. For any future biennium, the legislature needs to keep in mind that supplemental appropriation requests are common, with general fund supplemental appropriations averaging \$29 million per biennium over the past 10 biennia.

**Legislative Action:** The legislature approved supplemental appropriations for FY 2005 totaling \$55.3 million. For details, see page 131.

**Issue:** Neither the executive nor the legislature includes projections for supplemental appropriations in the 2007 biennium. Typically, the potential for supplemental appropriations is considered a component of the fund balance reserve. This speaks to the need for an adequate reserve, which is discussed later.

**Fiscal  
Challenge**

**State assumption of district courts** has been a difficult issue for the Judiciary since its implementation through SB 176 in the 2001 session. Although questions of who pays for what costs have been answered, there are still concerns that the program is underfunded. A sizable supplemental of \$5.8 million was requested for FY 2005 and this is also reflected in the Judiciary's request for the next biennium.

**Legislative Action:** The legislature approved a supplemental appropriation of \$5.8 million to fund variable cost overruns in the district court assumption program. The legislature also approved additional funding at the FY 2004 base level for the 2007 biennium for variable costs related to this activity, which are mostly comprised of public defender activities.

**Issue:** Since the implementation of SB 176 in 2001, the Judicial Branch has indicated that its budget to pay for the district court assumption was not adequately funded. The budget for the district court assumption is split into fixed and variable costs. The fixed costs primarily are comprised of employee payroll costs while variable costs are primarily for public defender services. One difficulty has been that the Judiciary does not budget and account for variable costs in a way that clearly reports those costs or offers an opportunity to control those costs. Before the variable costs can be fully addressed in the budget, there needs to be better accountability for those costs. The legislature passed SB 146, which approved the transfer of most of the variable costs in the district court assumption program to the Office of State Public Defender, effective July 1, 2006.

**Fiscal  
Challenge**

**Potential loss of federal funds** as a source of funding for many state and federal programs is a concern because of the large federal deficit and the administration's goal of cutting the deficit in half by 2008. The loss of federal funds translates to either reductions in services to citizens or increased state costs to offset the loss, loss of jobs in the state, and loss of "imported" money into the Montana economy.



**Legislative Action:** The legislative budget includes \$3.3 billion in federal funds for the 2007 biennium, a \$369.6 million, 12.8 percent increase over the 2005 biennium. While there was significant discussion of concerns over this issue, the only specific action taken by the 59<sup>th</sup> Legislature was to pass a resolution (HJR 26) to study financial reliance on federal funds and to provide recommendations for dealing with this liability.

**Issue:** The Montana budget has an increasing reliance on federal funds, as federal funds comprise 46.1 percent of the total proposed HB 2 budget. A significant federal cutback could have a devastating impact on government services in Montana and/or the state budget.

**Fiscal  
Challenge**

**Long-term stability of the general fund** becomes an issue when changing demographics become a big player in the demand for government services or are an influencing factor in the generation of state revenue. Emerging examples of potential instability are: 1) the aging population of Montana as well as other states; 2) dependence on revenue from the cigarette tax that is partly intended to discourage the use of tobacco products that generate the tax revenue; 3) the education funding lawsuit liability; and 4) the federal funds reliance issue discussed above.

**Legislative Action:** The legislature took some steps to address this issue. To the extent that the aging population issue is tied, either directly or indirectly, to caseload increases for services provided to seniors, some increases were approved, such as increases in the number of persons that are served by the community-based Medicaid waiver program. However, the emerging issues related to the aging population have not really been embraced by the legislature from a budgeting standpoint. Regarding cigarette tax revenues, the legislature addressed short-term concerns by delaying the implementation of programs funded by the tax, but have not addressed the long-term concerns of a declining revenue source. For the education lawsuit liability, the legislature did define a basic system of quality education but did not complete the funding component. A study committee is working on this aspect with a special session expected in late 2005. On the federal funds reliance issue, the legislature called for a study during the 2005-2006 interim.

**Issue:** The legislature needs to be cognizant of the long-term outlook for the general fund if a future budget crisis is to be avoided. The legislature may wish, at some point in time, to consider an interim study of the long-term stability of the general fund.

**Fiscal  
Challenge**

**Economic development** has been a high priority for the Governor's Office. Governor-elect Schweitzer campaigned strongly on economic development initiatives. What investment will be necessary to continue current efforts and/or fund new initiatives?

**Legislative Action:** The 2005 Legislature passed 12 bills that will have an impact upon economic and community development. Eight bills provide appropriations for economic and community development related activities. Two bills were enacted to stimulate business retention, expansion, or research through tax incentives. Two additional bills provide for other types of financing, or regulatory changes associated with removing or reducing impediments to economic and community development. The total amount appropriated is \$36.1 million in general fund and state special revenue.

**Issue:** As is true for many economic development efforts, there needs to be accountability for the investment that is committed to the project. Measurable goals and objectives, and related accountability measures, are critical in determining the effectiveness of these efforts.

**Fiscal  
Challenge**

**Controlled budget growth (structural balance)** will continue to be a concern, regardless of the sizable projected fund balance expected for the end of the 2005 biennium. A large portion of the available general fund revenues is from a one-time source. Temptations to use “one-time” revenue for “ongoing” programs and services will persist.

**Legislative Action:** The structural imbalance for the 2007 biennium is expected to be a negative \$5.1 million, although a structural balance is achieved by the end of FY 2007 (\$2.3 million positive).

**Issue:** The projected structural balance for FY 2007 is positive at \$2.3 million. Although the state could be considered structurally balanced at that time, there are fiscal “potholes” that could be troublesome as the state moves toward the next biennium. For example, the financial resolution to the public school lawsuit, the increased costs of the phased-in employee pay proposal, rising corrections populations, and continued double digit medical inflation coupled with the potential reduction in federal Medicaid funding could easily consume average revenue growth for the 2009 biennium.

**Fiscal  
Challenge**

**Adequacy of the ending fund balance** reserve will need to be monitored by the legislature as the session progresses. What will it take to ensure that Montana keeps an adequate “safety net” in place?

**Legislative Action:** The legislature ended the session with a general fund balance of \$76.0 million, a 2.5 percent reserve. This is the highest session ending general fund balance to date. However, national experts such as the National Conference of State Legislatures (NCSL) recommend a 3 to 5 percent reserve, and the 50 states average 5.3 percent reserve (2004 data from NCSL).

**Issue:** Although the fund balance is reasonable as a “safety net”, unexpected revenue shortfalls or unanticipated expenditures can quickly consume a reserve. Taking into account that supplemental appropriations and wildfire suppression costs average \$33.4 million per biennium (1987 to 2005), a balance of \$78 million leaves a fragile safety net. Montana is one of only three states without a rainy day fund and may want to consider setting up and placing seed money in a “rainy day fund”. Eight such bills have been debated in the past two sessions but none have been approved.

**Fiscal  
Challenge**

**Economic uncertainties** can undermine revenue-forecasting efforts, and contribute to an increased demand for government services in areas such as human services and corrections. As in any legislative session, there are many unknowns surrounding revenue forecasts. Oil and gas prices appear to be declining, interest rates are slowly increasing, and there is more talk at the federal level of income tax reform. Assumptions used in the revenue forecasting process are based upon the best information available, but what might happen to change those assumptions?

**Legislative Actions:** The legislature did not approve any major tax policy changes, nor did it address the strain of higher oil prices on the economy or the potential of federal fund reductions.

**Issue:** The current national economic picture is volatile at best, and with the inherent increase in government service demands and eligibility, are revenue estimates conservative enough, and can budgets be contained without cost over-runs?

**Fiscal  
Challenge**

**General fund spending without HB 2 appropriations** occurs in general fund non-budget transfers and through statutory appropriations. Authority for such spending is authorized in statute, but doesn't receive the usual scrutiny that HB 2 appropriations require. The challenge in this case is for the legislature to minimize the occurrence of spending that does not require regular scrutiny by the legislature.

**Legislative Actions:** The 2005 Legislature enacted 7 laws that increase general fund spending from statutory appropriations by \$1 million in the 2007 biennium. In addition, 13 new general fund transfers were enacted, totaling \$13 million over the 2007 biennium.

**Issue:** The legislature has established numerous statutory appropriations and transfers in statute, expenditures that do not receive the same scrutiny or prioritization as HB 2 appropriations. Statutory appropriations for the 2007 biennium are estimated to be \$269 million general fund and transfers are estimated to be over \$54 million.



## LEGISLATIVE BUDGET HIGHLIGHTS

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This section provides an executive summary of the legislative budget, including a discussion of the general fund ending balance projection, a summary of revenue estimates and an appropriations summary.

### GENERAL FUND

The general fund supports a majority of the general operations of the state, and represents about 37.5 percent of all state expenditures in the budgeted fund types in HB2 (general appropriations act) and HB447 (pay plan). The legislature also passed numerous “cat and dog” bills appropriating general fund.

The revised general fund balance at the end of the current 2005 biennium is projected to be \$162.4 million. This projected balance is \$116.2 million above the balance anticipated by the 58<sup>th</sup> Legislature, and is due primarily to general fund revenues coming in much stronger than projected. The primary income sources responsible for the revenue picture improvement are individual income, corporate income, and oil and natural gas production taxes. The reasons for the improvements are summarized on page 40 and in more detail in Volume 2, “Revenue Estimates”. With such a high beginning balance, and after applying the present law revenue estimates and present law funding of programs for the 2007 biennium, the 2005 Legislature had a \$274 million general fund balance to work with in crafting the 2007 biennium total budget. The legislature increased general fund appropriations by \$172 million with the most significant increases for human services, public education, corrections, and higher education, as well as for the state employee pay plan (\$36.0 million). “Cat and dog” bill appropriations added \$3.3 million. There was no significant tax policy/revenue legislation in the 2005 session impacting general fund.

Total general fund revenues are estimated to be \$2.887 billion for the 2007 biennium, a 3.9 percent increase (\$107.5 million) over the 2005 biennium. Included in this increase are the impacts of SB407 (individual income tax reduction adopted by the 2003 Legislature) and all other tax policy/revenue legislation enacted by the 59<sup>th</sup> Legislature. Total disbursements from the account for the 2007 biennium are estimated to be \$2.973 billion, which is an increase of \$320.8 million (12.1 percent) over the 2005 biennium. The significant disparity between increased revenues (\$107.5 million) and increased disbursements (\$320.8 million) is primarily explained by the drawdown of a large beginning fund balance discussed above. The projected general fund balance at the end of the 2007 biennium is \$76.0 million, including all initiatives adopted by the legislature. Please note that this projected balance does not include additional revenue currently being received in excess of the revenue estimates used by the 59<sup>th</sup> Legislature.

## REVENUE ESTIMATES

The legislature adopted 2007 biennium general fund revenue estimates in HJR 2 of \$2.905 billion, and other legislation enacted resulted in \$18.4 million in revenue decreases in the 2007 biennium, for a consolidated revenue projection of \$2.886 billion for the biennium. Income taxes account for 48.4 percent of the general fund revenues. Property taxes contribute 12.3 percent of the budget, consumption taxes about 8.6 percent, and vehicle taxes 5.6 percent (see page 49). Total general fund revenues for the 2005 biennium are projected to increase 3.9 percent over the 2005 biennium projections.

## TAX POLICY AND INITIATIVES

The 2003 legislature approved numerous bills with a general fund revenue impact, as shown in figure 7 on page 51. In total, they decreased general fund revenues by \$33 million, with SB 212 (a shift in allocation of U.S. mineral royalties between funds) accounting for 84 percent of the decreased revenue. There were no major changes in tax policy in the 2005 session.

A detailed discussion of revenues in the 2007 biennium begins on page 45 of this volume.

## APPROPRIATIONS HIGHLIGHTS

The legislature provided total general fund of \$2.6 billion and total funds of \$7.0 billion for the operations of state government in the 2007 biennium. Figure 1 shows the allocation of general fund by program area of government. Education, corrections, and human services consume 87.1 percent of this total, compared to 88.7 percent in the 2005 biennium.

Figure 1

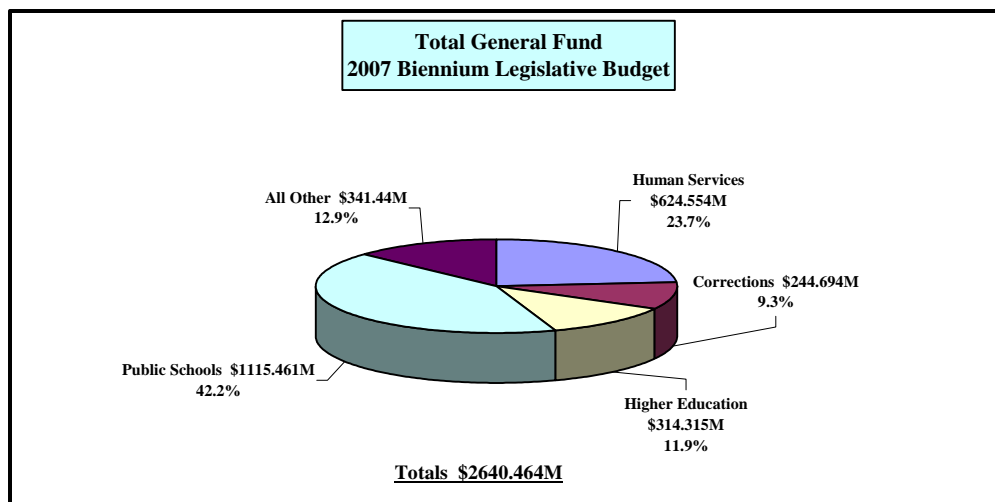
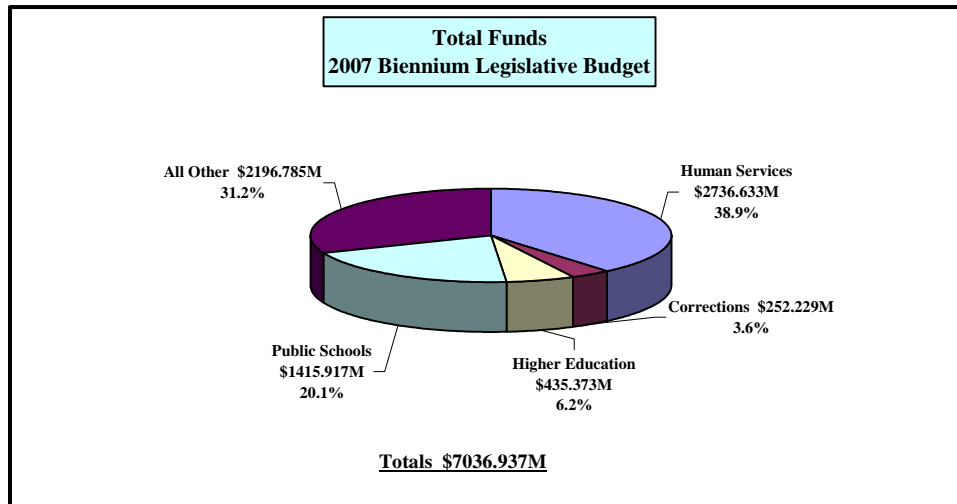


Figure 2 shows the allocation by program area of total funds. “All Other” includes the Department of Transportation. Because of the significant contribution of federal funds and use of non-general fund in transportation and human services, those two functions consume almost 55 percent of the total.

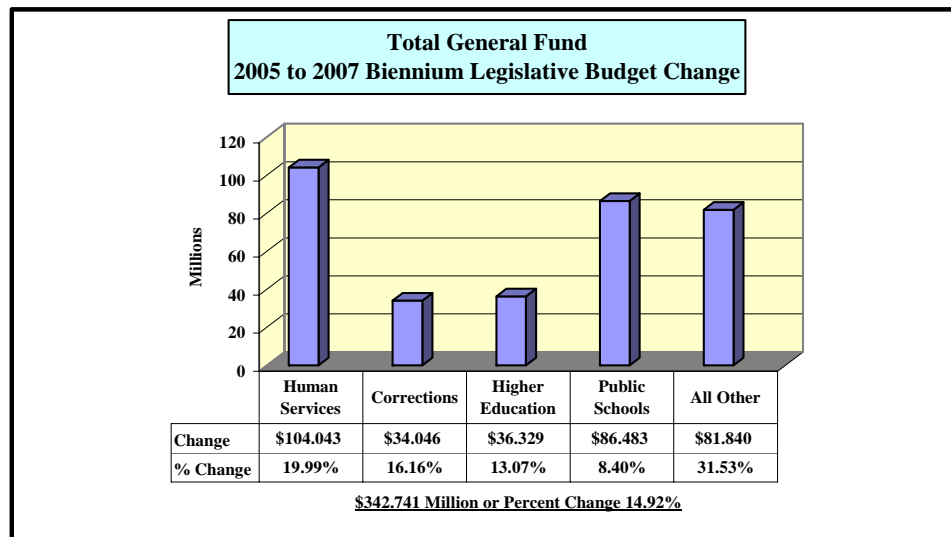
Figure 2



## INCREASES OVER THE 2005 BIENNIUM

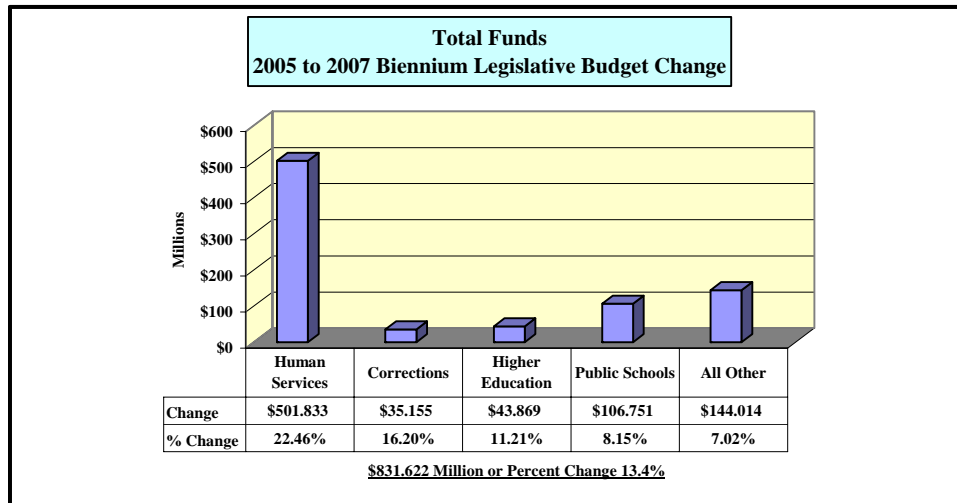
The 2007 biennium total in HB 2 and HB 447 is an increase in general fund of \$342.7 million or almost 15 percent, and in total funds of \$832.6 million or 13 percent over the 2005 biennium level. General fund increases are spread across state government, with human services and public schools receiving the largest share, as shown in Figure 3.

Figure 3



Total funds are dominated by increases to the Department of Public Health and Human Services, as shown in Figure 4.

Figure 4



## LEGISLATIVE PRIORITIES

As reflected in its approved budget, the legislature had a number of priorities for state government in the 2007 biennium. The following narrative discusses some of the major priorities by program area.

### **Human services** (increases of \$104.0 million general fund and \$501.8 million total funds)

- Maintain existing services to all currently eligible persons, including replacement of federal funds due to a reduction in the federal Medicaid participation rate
- Increase rates paid to human services providers and direct care workers
- Use existing and expanded state funding to maximize the receipt of federal funds to expand services, increase payments to providers, and expand Medicaid eligibility for children
- Increase the availability of prescription drugs and health insurance to a wider group of Montanans
- Expand children's health insurance
- Expand mental health, developmental disability, senior, and physical disability community services
- Maintain payments to TANF recipients

### **K-12 Education** (increases of \$86.5 million general fund and \$106.8 million total funds)

- Increase payments to schools and protect school districts with falling enrollments from sudden drops in funding
- Create and implement Indian Education for All
- Utilize all anticipated federal funds

### **Higher Education** (increases of \$36.3 million general fund and \$43.9 million total funds)

- Enhance access through:
  - Expansion of scholarships and other financial assistance
  - Provision of greater general fund support for operating costs to reduce tuition increases
  - Provision of additional support to Tribal colleges for non-beneficiary students
- Enhance funding for community and Tribal colleges
- Provide staffing and equipment to enhance other programs and services

### **Corrections** (increases of \$34.0 million general fund and \$35.2 million total funds)

- Provide services and/or facilities for all anticipated population increases
- Focus more on treatment and placement options by minimizing the increase in private secure care beds and expanding facilities for revocations and special needs inmates
- Increase payments to current providers

**Other Government** (increases of \$81.8 million general fund and \$144.0 million total funds)

- Utilize all anticipated federal funds, including highway construction funds
- Provide consistent and quality legal services to the indigent
- Expand or implement programs for economic development
- Complete or begin several computer systems
- Accelerate the water adjudication process

## STATE EMPLOYEES

FTE increase by 412.07, or 3.6 percent, in FY 2007 compared to the FY 2005 level funded by the 2003 Legislature.

- Environmental programs are 25 percent of the increase and are for a number of purposes, including replacement of contract IT with state employees, acceleration of the water adjudication process, completion of total maximum daily load duties, and provision of additional initial fire attack capabilities
- Staffing for a new Office of the Public Defender is over 20 percent of the increase and consists of new employees and those transferred from local governments in addition to current state employees
- Corrections staff is almost 18 percent of the total increase and is for additional probation and parole officers and to staff a new revocation center
- Transportation staff is over 15 percent of the total increase and is added for the new construction plan and to integrate financial systems

A detailed discussion of appropriations in the 2007 biennium budget begins on page 69 of this volume.





How does the 2007 biennium budget compare to:

- The executive budget proposal?
- Prior biennium expenditures?
- Fund sources?



## **BUDGET COMPARISONS SUMMARY**

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### **INTRODUCTION**

The following highlights the budget comparisons that are presented in detail beginning on page 89. The three comparisons are: 1) budget levels of the legislative 2007 biennium budget to the Governor's budget request; 2) comparison to the prior biennium expenditures', and 3) a "by fund" biennial comparison.

### **COMPARISON TO THE EXECUTIVE BUDGET**

The 2007 legislature passed a budget in HB 2 and HB 13 that is net \$63.5 million general fund higher and \$64.7 million total funds higher than the level requested by Governor Schweitzer. This difference is the net of a large number of partially offsetting increases and decreases. The major differences are:

- The pay plan, proposed by Governor Schweitzer but not incorporated into agency budgets at the time of publication, represent \$36.0 million general fund and \$70.3 total funds of the difference. (If the pay plan is excluded, the total difference in general fund is less than 1.1 percent.)
- For K-12 education, \$19.5 million general fund over the executive request was added for three year averaging of enrollments for purposes of determining ANB and for an increase in an entitlement per both elementary and high school students.
- Department of Public Health and Human Services appropriations exceed the executive request by \$1.6 million general fund and \$78.6 million total funds. Generally, the changes related to legislative initiatives, addition of matching funds for I-149 initiatives, continuation and in some instances increases in bed utilization fees, increases in Medicaid caseload estimates during the session, and the denial of the executive request of additional energy assistance funding.
- For the Department of Corrections, the legislature approved most of the executive decision packages and added \$10.7 million in additional funding to cover projected increases in the adult average daily populations (ADP) of about 4.5 percent in each fiscal year of the biennium. In addition and at the request of the executive, the legislature did not fund an offender tracking system.
- In the Department of Transportation, the difference between the legislative budget and the budget proposed by the executive is primarily due to two factors: 1) the construction plan was updated by the executive to reflect anticipated activities during the biennium, and 2) the legislature chose to provide appropriation authority for highway 93 bonding in HB 5, rather than HB 2, due to the long-term bonding nature of the project.

See page 89 in this volume for additional detail regarding the comparison of the legislative 2007 biennium budget to the Executive Budget.

## BIENNIAL BUDGET COMPARISONS

The legislature adopted a 2007 biennium spending plan that is a \$344.1 million (13.4 percent) increase in general fund, and a \$824.3 million (12 percent) increase in total funds, when looking at all comparable appropriations. When looking at just HB 2 and HB 13, the general fund increase is \$342.7 million or 14.9 percent, and the total funds increase is \$831.6 million or 13.4 percent. The most significant increases in general fund appropriations occur for programs in the Department of Public Health and Human Services (\$104 million), Office of Public Instruction (\$86 million), Commissioner of Higher Education (\$36 million), and the Department of Corrections (\$34 million). However, the largest increases in percentage terms occur in the departments of Commerce, Administration, Montana Arts Council, and Labor and Industry. The discussion of budget comparisons begins on page 92 of this volume. For detail relating to individual state agencies, see Volume 3 or Volume 4.

## AGENCY BUDGET COMPARISON BY FUND

This comparison, detailed beginning on page 96, looks at appropriations contained in HB 2 and HB 13 (except for contingency funds). These are, by fund type, a comparison of the 2005 and 2007 biennium agency appropriations. The total funds increase is \$831.6 million, a 13.4 percent budget increase. Federal fund increases constitute about 44 percent of all budget increases and general fund increases constitute 41 percent. About 14 percent of the increase was state special revenue funds.

General fund increases by net \$342.7 million, or 14.9 percent. Major reasons for this net increase are:

- K-12 education for inflationary adjustments, 3-year averaging of enrollment for entitlement calculation purposes, an increase in entitlement payments for both elementary and high school students, and increases to several other payments to schools such as special education
- Within human services, replacement of federal funding due to a reduction in the federal Medicaid participation rate, caseload and utilization increases (primarily Medicaid), service expansions, provider and direct care worker rate increases, and increased institutional costs
- Measures to address increasing corrections populations, including additional probation and parole officers, a revocation center, and services and facilities for special needs inmates
- Several initiatives in higher education, including expanded community and Tribal college support, "shared leadership" initiatives, student financial assistance, and an increase in the level of general fund used to fund several present law adjustments to reduce tuition increases
- The 2007 biennium pay plan
- Computer systems, including funding replacement

State special revenue increases by \$118.4 million, or 11.9 percent, with more than three quarters of that increase coming from increases in the Department of Public Health and Human Services. These increases relate to expenditure of funds generated by passage of I-149 in November 2004 for various health initiatives. Other significant increases occurred in the Department of Labor and Industry for increased professional and occupational board activity; in the Department of Fish, Wildlife, and Parks for a hunter access program and other activities, and in the State Auditor's Office for implementation of tax credits for small employer health insurance enacted in HB 667. Several agencies have decreases in state special revenue spending with the largest being \$14.5 million for the Department of Environmental Quality and \$10.2 million in the Governor's Office budget.

Federal funds increase by \$396.6 million, or 12.8 percent. The increase is spread throughout state government, but the Department of Public Health and Human Services receives almost \$306 million, or over 82 percent of the increase. The major factors causing the increase in federal funds are:

- Caseload growth, service utilization, and inflation, particularly in Medicaid, food stamps, childcare, and TANF
- Provider rate increases (including an expansion in voluntary hospital and nursing home bed tax assessments used to match federal funds) and direct care worker wage increases;
- Service expansions, in large part through Medicaid redesign; and
- New or expanded categorical grants.

These increases are partially offset by a reduction in the federal Medicaid participation rate. Within other agencies of state government, increases in federal funds are due to increased activity and/or grant awards in several agencies, most notably the Office of Public Instruction and environmental/wildlife agencies; addition of authority to implement the Help America Vote Act in the Secretary of State's Office; and increased student loan volume in the Montana University System.

Proprietary funds show a net decrease of \$0.9 million, or 3.4 percent, primarily due to the addition of funds for completion of a gambling automated accounting and reporting system.



What other fiscal issues addressed by the 2005 Legislature are important to consider?



## HIGHLIGHTS OF OTHER BUDGET OR FISCAL ACTIONS

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The “Other Budget or Fiscal Actions” section (page 103) discusses several issues of either statewide or multi-agency fiscal impact. It addresses significant issues contained in HB 2, other “cat and dog” bills, statutory appropriations, and issues not related to any specific legislation. The following provides highlights of those issues.

- **State Employee Pay Plan (HB 447).** (page 105) The legislature passed a pay plan (HB 447) that includes: 1) an increase in employer contributions for health insurance of \$46 per month on January 1, 2006 and \$51 per month on January 1, 2007; and 2) pay increases on October 1 for each year of the biennium. The pay increase provides 3.5 percent or \$1,005 annually (whichever is higher) in FY 2006 and 4 percent or \$1,188 annually (whichever is higher) in FY 2007. In addition, HB 447 includes a contingency fund of \$1.5 million general fund and \$3.0 million other funds to assist agencies that have personal services budget shortfalls. The total cost of the pay plan is \$37.6 million general fund and \$37.0 million other funds.
- **State Employees – FTE Summary.** (page 107) HB 2 provides funding for a total 11,533.57 FTE state employees in FY 2006 and 11,697.52 in FY 2007, excluding the units of the Montana University System. These totals represent an increase of 412.07 FTE (3.7 percent) in FY 2007 over the FY 2005 level used for budgeting purposes.
- **Vacancy Savings.** (page 110) The legislature accepted the executive's recommendation to apply a 4 percent vacancy savings rates, with some additional exceptions – the Highway Patrol, the Student Services and Education Programs of the School for Deaf and Blind, and field services for the Child and Family Services Division of the Department of Public Health and Human Services. For the first two exceptions, no vacancy savings was applied, and for the third, a 2 percent vacancy savings was applied. The reduction applied in the state budget, excluding the university system, is estimated at \$16.8 million general fund and \$24.2 million other funds.
- **Public School Funding.** (page 111) In response to the school funding lawsuit, the 2005 Legislature passed SB 152, creating a definition of a basic quality school system that includes recognition of the resources required and the population served. The legislature also passed SB 525, which creates an interim committee to conduct a cost study, develop the funding formula and recommend revenue changes in preparation for a special session on school funding in December 2005. Although a new funding system might affect state spending on schools as early as FY 2007, the legislature appropriated funding for both years of the 2007 biennium by passing HB 63, which provided \$66.8 million in additional Base aid over the FY 2004 base levels. Additional increases totaling \$18.9 million for schools were included in HB 2, the general appropriation act, for such programs as special education, school facilities, vocational education, gifted and talented, and Indian Education for All.
- **Long Range Planning Summary.** (page 114) The 2005 Legislature approved \$473 million of grants, loans, and capital projects in the Long Range Planning (LRP) program, more than twice

the funding appropriated in these programs in the 2005 biennium. The marked increase in appropriations resulted in large part from several one-time general fund transfers and unusual appropriations in LRP programs. Funding for the LRP programs is derived from a number of different sources, with state special revenue being the largest. Grants, donations, proprietary funds, and higher education funds are the second largest source and general obligation bonds is third.

- **St. Mary Facility Rehabilitation.** (page 117) In earlier biennia, the legislature has only appropriated funds to repair serious system problems, but the 2005 Legislature took a more proactive position in relation to the project. Responding to the need for the rehabilitation of the St. Mary facilities, the legislature took steps to get the rehabilitation work started. One important action taken by the legislature was to approve SJ 9, a joint resolution requesting federal funding for the rehabilitation of the St. Mary diversion facilities and urging the support of the Montana Congressional delegation. In addition to the resolution, the legislature appropriated almost \$12 million for the initial project work.
- **Other Appropriation Bills.** (page 119) Beside HB 2, several bills were enacted that appropriated \$39.5 million in general fund, \$227.7 million in state special revenue, and \$137.8 million in other funds. Most of the general fund amount is from the state employee pay plan and most of the other funds relate to long-range building costs and expenditures of the nursing home bed utilization fee combined with the federal Medicaid matching funds.
- **Status of Tobacco Settlement Funds.** (page 122) Payment of tobacco settlement funds of \$42.1 million is expected for the 2007 biennium and interest earnings of the tobacco trust are estimated at \$7.1 million. The trust fund receives 40 percent of the settlement payments and 10 percent of the interest earnings. The general fund receives 11 percent of the payments. The remaining 59 percent of the settlement payments and 90 percent of the interest earnings are allocated to specific uses including treatment and prevention efforts and health insurance for children and others that would otherwise be uninsured.
- **Cigarette and Tobacco Tax Funds: Initiative-149.** (page 124) I-149, passed by voters in November 2004, raised taxes on tobacco products, most notably a \$1 increase per pack of cigarettes; created the health and Medicaid initiatives account for receipt of tobacco tax revenues; and established uses for I-149 revenues:
  - State matching funds to maximize enrollment of eligible children in CHIP
  - Need based prescription drug program for children, seniors, chronically ill, and disabled persons
  - Increased Medicaid services and Medicaid provider rates
  - Tax credits for small employers for assistance in providing health insurance to their employees

The new account is projected to receive \$99 million through the end of FY 2007. Because the legislature was concerned about the level of revenues that the state would receive, it delayed implementation by 6 months and lowered overall appropriations to about \$61 million. The legislature passed two bills (SB 324 – prescription drug program and HB 667 – health insurance tax credits and premium assistance for small employers) to implement I-149 and made various appropriations in HB 2.

- **Office of State Public Defender.** (page 129) The 2005 legislature passed SB 146, which establishes the Office of State Public Defender, partially in response to a lawsuit filed in district court. The lawsuit alleged that defendants that are indigent are not being provided public defender services in a fair and consistent manner among jurisdictions. Also, it argued that the current system of public defense in the state creates a conflict of interest when the judge appoints a public defender for a case that is being adjudicated by that judge. Besides moving

the public defender from one that is locally managed by numerous jurisdictions, to one managed from a statewide perspective, the legislation created a commission to head the statewide system. The total cost in the 2007 biennium is \$14.7 million general fund. When these costs are annualized for the 2009 biennium, the cost will be about \$28.3 million. Most of the spending authority for this new state level program comes from existing public defender budgets. Only \$5.7 million in new state money (in HB 2) is added in the 2007 biennium.

- **FY 2005 Supplemental Appropriations.** (page 131) The legislature provided state agencies with an additional \$55.3 million general fund in FY 2005, with the largest items being \$16 million to pay off the loan for the Department of Revenue computer system, \$9 million to complete the Crow Tribe settlement, and \$8.5 million for the settlement of the highway patrol officers' lawsuit.
- **Fund Balance Adequacy/Reserves.** (page 136) The legislature adopted a budget that includes an ending fund balance of \$76 million.
- **Federal Jobs and Growth Tax Relief Funds.** (page 138) The federal Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRR), enacted in 2003, included \$20 billion in state assistance, half for enhanced federal matching payments for Medicaid, and half for flexible assistance to states to support essential government services and unfunded federal mandates. Montana received \$50 million in support for essential state services or unfunded federal mandates and an additional approximately \$21.3 million in enhanced federal Medicaid payments (through an increased federal funds match rate) in FY 2003 and FY 2004. This one-time money was expended or committed prior to the 2005 session, but still was a consideration in the formulation of the 2007 biennium budget. Since the moneys were used in many cases to backfill the shortfall in general fund revenue that occurred in 2003 and 2004, the 2005 Legislature restored funding for some programs. For example it is estimated that the legislature added \$15 million general fund in the 2007 biennium to replace the expired additional federal Medicaid matching rate.
- **Information Technology Major Projects: Status.** (page 142) The 2005 Legislature funded several major information technology projects. It appropriated funds (\$21.4 million) to retire the debt and to complete the Department of Revenue's Integrated Revenue Information System (IRIS) project in the 2007 biennium. The legislature also funded a project to replace the existing, obsolete property tax system with a new commercial off-the-shelf system. The legislature appropriated one-time funding of \$5.5 million general fund to develop and implement a new system that will interface with IRIS, but not be a component part of IRIS, for completion in the 2007 biennium. In addition, the legislature appropriated \$448,000 state special revenue to integrate Department of Transportation financial systems over multiple biennia. The legislature also approved \$1.1 million in general fund for the Judiciary to purchase case management systems and related technology for district courts and courts of limited jurisdiction.
- **Economic Development.** (page 144) The 2005 Legislature passed legislation or made appropriations that will have an impact upon economic and community development efforts in three distinct categories: 1) a direct investment category includes legislation that provides an appropriation for economic and community development related activities; 2) the tax related initiatives category includes legislation that was enacted to stimulate business retention, expansion, or research through tax incentives; and 3) the "other" category includes all other legislation, some of which may be associated with bonding activity, other types of financing, or regulatory changes associated with removing or reducing impediments to economic and community development. The total amount appropriated is \$36.1 million, of which \$7.9 million is general fund.
- **Pension Funds – Unfunded Liabilities.** (page 147) The legislature did not pass legislation that would have raised the employer contribution rates for state retirement systems. Instead,



the legislature, in HJR 42, requested a legislative study on how public employee retirement funds are invested and how investment performance, retirement plan benefits, and legislative policy decisions interact to affect the actuarial soundness of the public employee retirement plans and employers' funding obligations.

- **General Fund/State Special Revenue Fund Statutory Appropriations.** (page 148) Statutory appropriations are a special kind of legislative appropriation. Unlike temporary appropriations that expire in two years (such as those in the general appropriations act), statutory appropriations are, as their name suggests, in statute and are not part of the biennial budgeting process. Seven bills were enacted in the 2005 session that increased general fund statutory appropriations by a net \$1 million in the 2007 biennium.
- **General Fund Non-budgeted Transfers.** (page 152) Like statutory appropriations, transfers and their authorizations are in statute and are not part of the biennial budgeting process, yet they affect the amount of money available for the legislature to appropriate for specific programs. Thirteen additional general fund transfers at a cost of \$13 million in the 2007 biennium were enacted by the legislature.
- **Proprietary Funds and Rate-Setting.** (page 154) The 2005 Legislature made one major change in internal services funds through reorganization. Responsibility for the maintenance of the capitol complex grounds has been transferred from the Department of Fish, Wildlife, and Parks to the Department of Administration, General Services Division. No change was made in either the methodology for assessing agencies for this cost or in the level of assessment made. The function is now part of the facilities management function.
- **Funding Switches.** (page 155) General fund is increased by \$67.6 million as a result of funding switches, while other funds are reduced by \$65.7 million. There are four major causes of the large amount of funding switches: 1) change in the Medicaid matching rate; 2) reallocation of revenues to the general fund; 3) legal concerns; and 4) loss of federal funds. Miscellaneous causes account for the remaining switches.
- **Fee Changes.** (page 157) In approximately 40 bills, the 2005 Legislature enacted changes to fees (increases or decreases) and created new fees that will raise an estimated net \$61.5 million in the 2007 biennium. Of that amount, \$37.4 million is reflected in appropriations in the general appropriations act (HB 2). The increased fee revenue, which will mostly be deposited in accounts other than the general fund, will be used to fund new and existing agency programs.
- **Legislative Interim Studies.** (page 158) The legislature approved 22 interim studies that have been assigned to various interim committees.
- **Other Major Funds.** (page 159)
  - Highways Special Revenue Account – Projections for the highways state special revenue account indicate that expenditures from the account will exceed account revenues and the working capital balance would be depleted by the end of FY 2007. This situation of excess expenditures is expected to continue through the foreseeable future. Expenditures at the level appropriated by the legislature are expected to exceed revenues by nearly \$53.7 million during the 2007 biennium and the account is forecast to end the 2005 biennium with a nearly depleted account balance. At the current level of services, expenditures could exceed revenues by nearly \$44.0 million during the 2009 biennium.
  - Resource Indemnity Trust – In February of 2002, the Governor certified that the balance of the RIT trust had exceeded the \$100 million threshold. Consequently, the trust no longer receives revenue. Interest earnings are used as a funding source for several funds, and the amount of revenue in excess of the \$100 million corpus is available for appropriation. The legislature appropriated funds from the corpus of the trust, interest

- from the trust, and indemnity related taxes to provide \$27.6 million worth of support to two universities, four agencies, and numerous local governmental agencies through the grant and loan programs. Five pieces of legislation were passed that affected the utilization of trust dollars through transfers and new appropriations. The legislature also chose to address the issues regarding the potential inappropriate utilization and lack of oversight of the funds, by passing a resolution for a study of the structure, historical usage, and statutes related to the resource indemnity funds.
- Coal Severance Tax Shared Account – The coal tax shared account receives a portion of coal severance revenues for further distribution to specific programs. Entities in the coal tax shared account include the Coal Board in the Department of Commerce (through FY 2005), Conservation Districts in the Department of Natural Resources and Conservation, Growth Thru Agriculture in the Department of Agriculture, and the Montana State Library Commission. Two pieces of legislation were passed that affected the allocation of tax dollars to the fund. HB 482 increases the amount of coal severance tax revenues flowing into the coal tax shared account from 7.75 percent to 8.36 percent. The legislature appropriated increases in state special revenue by \$389,606 to implement the provisions in HB 482. HB 758 creates a new oil, gas, and coal natural resource state special revenue account, which dedicates revenue to the Department of Commerce and the Department of Revenue. Revenues for the new account come from the coal severance tax and the oil and gas production tax. Passage of HB 482 allocates 8.36 percent of the coal severance tax revenues to the coal tax shared account, a state special revenue account. However, HB 758 will reduce this amount to 5.46 percent, and the difference, 2.90 percent, will go to the new account and be administered by the Coal Board in the Department of Commerce. The Coal Board will no longer be a participant in the coal tax shared account.





## 2009 BIENNIUM OUTLOOK

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### GENERAL FUND

#### STRUCTURAL BALANCE

Structural balance is defined as the matching of *ongoing* revenues with *ongoing* expenditures. If revenues equal or exceed expenditures, structural balance is achieved. Conversely, if expenditures exceed revenues, structural imbalance occurs. By the end of the 2007 biennium, the general fund structural balance is expected to be a positive \$2.3 million, even though a negative structural balance in FY 2006 makes the biennium appear to have a structural imbalance of a negative \$5.1 million.

#### OUTLOOK FOR THE 2009 BIENNIUM

The projected structural balance for FY 2007 is positive at \$2.3 million. Although the state could be considered structurally balanced at that time, there are fiscal “potholes” that could be troublesome as the state moves toward the next biennium. For example, the financial resolution to the public school lawsuit, the increased costs of the phased-in employee pay proposal, rising corrections populations, and continued double digit medical inflation coupled with the potential reduction in federal Medicaid funding could easily consume average revenue growth for the 2009 biennium. Structural balance depends on the ability of ongoing revenue to meet anticipated present law disbursement costs. If average revenue growth is in the range of 3.0 to 3.5 percent per year, then the costs of present law services cannot exceed this amount without tax policy modifications and/or an adjustment to services provided.

### HIGHWAYS STATE SPECIAL REVENUE ACCOUNT PROJECTIONS

The highways state special revenue account funds the Department of Transportation highway planning, construction, and maintenance activities, highway safety enforcement activities in the Department of Justice, road maintenance functions in state parks, and capital projects related to highways infrastructure. The highways state special revenue account is chronically structurally imbalanced, and the level of revenue growth cannot sustain the level of expenditure growth needed to support the services provided. The projections show the account is anticipated to be expended at a higher level than expected revenues for the 2007 biennium (expenditures will exceed revenues by \$53.7 million), and the account is projected to go negative in FY 2007. If federal funds increase as anticipated when federal highway funding legislation is reauthorized, and if a full match of available federal funds is to be achieved to provide a fully funded highways program, a revenue increase may be needed.

